FILE COPY

Office - Supreme Court, U. S.
FILED
MAR 19 1948
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 684

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

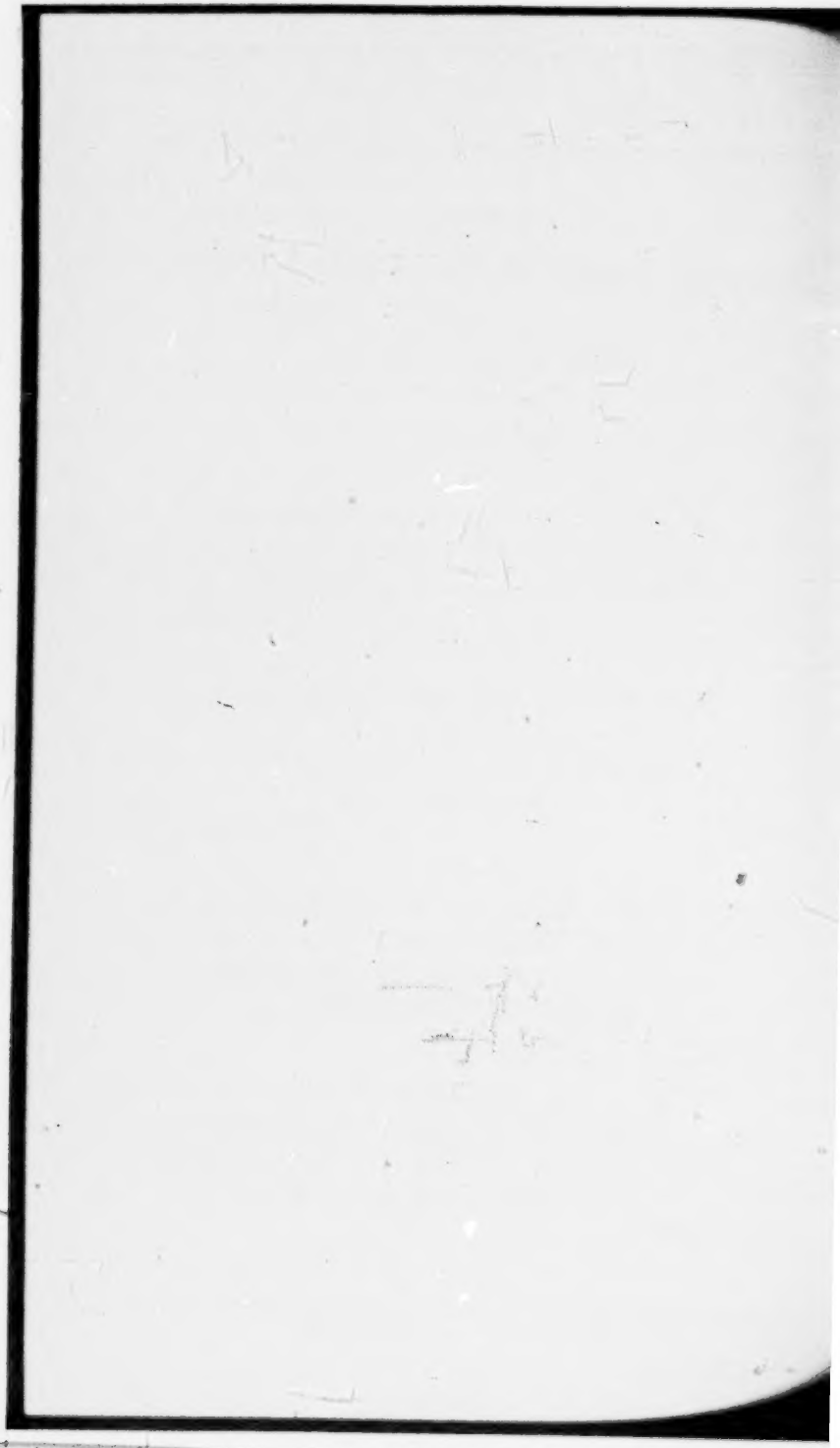
A. RAYMOND MACHEN, TRUSTEE
in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

NATHAN PATZ,
Attorney for Petitioners,
Baltimore Trust Building,
Baltimore 2, Maryland.

March 19, 1948.

The Daily Record Co., Baltimore 3, Md.



INDEX

	PAGE
PETITION FOR WRIT OF CERTIORARI:	
OPINIONS OF THE COURTS BELOW	2
JURISDICTIONAL STATEMENT	2
STATUTES INVOLVED	2-3
SUMMARY STATEMENT OF THE CASE (including outline of facts)	3-6
NATURE OF THE PROCEEDINGS BELOW	7
THE QUESTIONS PRESENTED	8
REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT	9-10
CONCLUSION	11
BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI:	
INTRODUCTORY (including comment on facts)	1-5
ARGUMENT	5-16
First Point: Alleged "compromise" an illusion	5
Second Point: Guarantors obtained a voidable preference, as defined by 1938 Bankruptcy (Chandler) Act:	
a. Guarantors are Creditors	7
b. Banks' Right of Set-Off	7-10
c. The Chandler Act (1938)	10-13
d. Equality is Equity	13
e. Guarantors Received a Preference	14-16
CONCLUSION	16

Table of Cases

[Key: (P)=Petition; (B)=Brief]

PAGE

Bank vs. Massey, 192 U. S. 138 ..... (B) 5, 9
Citizens Nat. Bank of Gastonia, N. C. vs. Lineberger, 45 F. (2d) 522 ..... (B) 11, 12, 16
Drugan vs. Crabtree, 299 F. 115 ..... (B) 11, 16
Goldman vs. Cohen, 1 Cir., 250 F. 599 ..... (B) 7, 15
Paper vs. Stern, 198 F. 642 ..... (B) 7, (P) 10
Sampsell vs. Imperial Paper Corporation, 313 U. S. 215 at 219 ..... (B) 13
Schleicher Printing Corp., 62 F. (2d) 503 ..... (B) 7, (P) 10, (B) 14
Swarts vs. Siegel, 117 Fed. 1, 13 ..... (B) 15
U. S. Bank vs. Chase Bank, 331 U. S. 28 ..... (B) 13
Walker vs. Wilkinson, 3 F. (2d) 867 ..... (P) 10, (B) 14

Table of Statutes and Other Authorities

U. S. C. A., Title 11, Sec. 1 (25)—Definition of "transfer"—prior to 1938 ..... (P) 2, 3
U. S. C. A., Title 11, Sec. 1 (30)—Definition of "transfer"—since 1938 ..... (P) 2, 10
U. S. C. A., Title 11, Sec. 47c ..... (P) 2
U. S. C. A., Title 11, Sec. 96 (Sec. 60 of Bankruptcy Act—Preferences) ..... (P) 2, (B) 7, 8, 9, 10
U. S. C. A., Title 11, Sec. 108 (Sec. 68 of the Bankruptcy Act—Set-Off) ..... (B) 7, 8, 9, 10
U. S. C. A., Title 28, Sec. 347 (240 (a) of the Judicial Code) ..... (P) 2
U. S. C. A., Title 41, Sec. 15 (1940 Act: Assignment of Claims) ..... (P) 5
Collier on Bankruptcy, 14th Edition, Secs. 60.15 and 60.17, Vol. 3, p. 811 ..... (B) 7, 12, 15
Collier on Bankruptcy, 14th Edition, Sec. 68.01, Vol. 4, p. 705 ..... (B) 12
Glenn, (2), Fraudulent Conveyance and Preferences, 1940, Secs. 460-462 ..... (B) 7

PAGE

Weinstein, The Bankruptcy Law of 1938—Chandler Act, Commentary by Author ..... (B) 10, 11

Weinstein, The Bankruptcy Law of 1938—Chandler Act, Foreword by Sponsor of Chandler Act ..... (B) 10

INDEX TO RECORD

Petition of Trustee for approval of settlement 1-6

Attached Exhibit No. 1 from Baltimore National Bank, First National Bank and the Messrs. Cummins 6-9

Attached Exhibit No. 2, Letter to Trustee from Baltimore National Bank 10-11

Attached Exhibit No. 3, Trustee's acknowledgment of receipt of offer of settlement 11-12

Order of Referee ratifying nisi proposed settlement 12-14

Final order of Referee ratifying settlement 14-15

Creditors' petition to review Referee's order 15-17

Referee's finds of fact and conclusions of law 17-19

Trustee's exception to claim of Baltimore National Bank (Recipient under old assignment of contract) 20

Testimony and statements produced at hearing before Referee 20-45

Note: Including statements of counsel for Trustee and creditors and for the Baltimore National Bank as presented at the Referee's hearing.

Trustee's Exhibit No. 5, Sheet 6, (Bankrupt's $10,000.00 note to Baltimore National Bank) 45-46

Trustee's Exhibit No. 5, Sheet 7 (Bankrupt's note for $25,000.00 to Baltimore National Bank) 46-47

Trustee's Exhibit No. 5, Sheet 8 (Bankrupt's $35,000.00 note to Baltimore National Bank) 48-49

PAGE

Trustee's Exhibit No. 7 (Letter of December 8, 1944, from one of guarantors to Baltimore National Bank and First National Bank settling remaining liability of guarantors to said banks) 49-50

Trustee's Exhibit No. 8 (Letter of the Banks of December 8, 1944 to the Guarantors) 51-52

Loan agreement between Bankrupt and its joint venturer with the Baltimore National Bank and the Guaranty Trust Company of New York dated December 17, 1942 52-55

Opinion of the District Court (Hon. William C. Coleman) 55-70

Order of Court (June 5, 1947) ratifying agreement of proposed settlement with modification requiring payment of interest by Baltimore National Bank 70-71

Consent of the Banks and of the Guarantors to the Court's modification requiring interest payment 71-72

Abstract from "Designation of Contents of Record on Appeal" on appeal to Circuit Court of Appeals 73

Statement of Points on appeal to the Circuit Court of Appeals 75-76

Testimony taken before Referee on June 4, 1946 76-122

Proceedings in the Circuit Court of Appeals 123

Opinion of the Circuit Court of Appeals 124-132

Judgment and Order of the Circuit Court of Appeals, December 22, 1947 133

Stipulation between counsel as to contents of record for the purpose of petition for Writ of Certiorari 134

Certificate of Clerk of Circuit Court of Appeals 135

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. ------

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

A. RAYMOND MACHEN, TRUSTEE
in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

TO THE HONORABLE: THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitioners respectfully pray that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Fourth Circuit, to review the Order and Judgment of that Court entered on December 22nd, 1947 (R. 133), which affirmed an order of the United States District Court for the District of Maryland entered on June 5th, 1947 (R. 70, 71).

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals for the Fourth Circuit appears in the Record at pages 124 to 132, and is reported in 164 Fed. (2) 983.

The opinion of the District Court for the District of Maryland appears in the Record at pages 55 to 70, and is reported in 72 Fed. (S) 409.

JURISDICTIONAL STATEMENT.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended (28 U. S. C. A. Sec. 347) and Section 24 (c) of the Bankruptcy Act (11 U. S. C. A. Sec. 47 c), agreeably to Rule 38 of this Court.

STATUTES INVOLVED.

52 Stat. 869, 11 U. S. C. A. Sec. 96 (1943).

> "Sec. 60. Preferred Creditors.—a. A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy * * *, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class; * * *".
>
> "b. Any such preference may be avoided by the Trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when such transfer is made, reasonable cause to believe that the debtor is insolvent."

The term *"transfer"* as now used in the Act, its scope and meaning are particularly defined by Section 1 (30) of U. S. C. A., Title 11. This definition was first incorporated by the Chandler Act (in 1938) and is considerably ex-

panded over that previously employed in the Bankruptcy Act (Sec. 1 (25) of U. S. C. A., Title 11)—prior to the 1938 amendment.

Now, and since 1938, the term *"transfer"*, as used in the aforegoing section 60 of the Act:

> "shall include the sale and every other and different mode, *direct or indict*, of disposing of or parting with property *or with an interest therein* or *with* the possession *thereof or of fixing a lien upon property or upon an interest therein*, absolutely or conditionally, *voluntarily or involuntarily, by or without judicial proceedings*, as a *conveyance, sale, assignment*, payment, mortgage, *lien, encumbrance*, gift, *security or otherwise.*" (Italics supplied, see below.)

By contrast the earlier definition read so as to provide only that:

> " 'Transfer' shall include the sale and every other and different mode of disposing of or parting with property, or the possession of property, absolutely or conditionally, as a payment, pledge, mortgage, gift or security."

To render in sharper contrast the added scope and coverage in the definition of the term *"transfer"* accomplished by the 1938 amendment over the earlier definition, which controlled decisions of the Courts prior to 1938, we have italicized above so much of the *1938 definition* as did not appear in the Bankruptcy Act prior to the Chandler amendment.

SUMMARY STATEMENT OF THE CASE.

The pivotal matters of facts here involved are so free of dispute as to be virtually stipulated.

The bankrupt had been engaged in the construction industry; for months prior to its adjudication on January

4th, 1945, it had ceased to function as an active and going concern; it had been long pressed by its outstanding creditors for payment (claims have been filed in excess of $410,000); a large Government construction contract had been earlier terminated; its officers, directors and stockholders (Messrs. Charles, Harold, John and Albert Cummins) had guaranteed its obligations to two Baltimore banks, represented by notes of the Corporation to such Banks for loans previously advanced.

With knowledge of the right of the two Banks to apply or set-off any balances in bank in reduction of the corporation's outstanding note obligations held by such Banks (which application would reduce the individual liability of the Messrs. Cummins as guarantors) the Officers (Guarantors also) continued in the weeks prior to October 16th, 1944, to make deposits of corporate funds in such Banks, though they also maintained a third depositary, to which Bank the Company was not indebted (R. 32).

On October 16th, 1944, shortly after a visit to both Banks by one of the Guarantors (i.e., Officers of the Bankrupt) by which date it was fully evident that the Corporation was knowingly insolvent, both Banks applied the Bankrupt's cash balances on deposit with them, in an amount in excess of $68,500, in reduction of such outstanding note claims of the Banks against the Bankrupt, upon which the Messers. Cummins were individually and unqualifiedly liable as guarantors.

On December 6th, 1944 (nearly two months after the above occurrences and within one month of the Bankrupts adjudication) one of those Banks (R. 3) under the circumstances next recited, received $45,103.73 under an old and inadvertently unrevoked assignment of funds to accrue under a Government contract, one half of which

($22,551.86) such Bank then sought to apply to the old balances still due upon the aforementioned notes of the Bankrupt, guaranteed by the Messrs. Cummins (R. 4).

The circumstances under which such Bank received those funds are:

(a) In 1942 when the Bankrupt and a co-venturer were awarded a large government construction contract (later terminated by the Government), the joint venturers made arrangements with this Baltimore bank to act as Agent for itself and a New York bank in loans to be made to the joint venturers by both banks (in proportions of one-sixth and five-sixths up to a maximum of $3,000,000) for use exclusively in the financing of the cost of construction of such joint contract (R. 52-55).

(b) At that time (1942) an assignment was executed (under the Assignment of Claims Act, Title 41 U. S. C. A. Sec. 15-1940) by the joint venturers to the Baltimore bank, as agent, by which sums payable under the joint contract would be paid to the Baltimore bank, as agent, *only* to secure repayment of the unpaid loans to be made by the Banks to the joint venturers for use *only* in the joint undertaking;

(c) Though all loans ever advanced under this arrangement had been admittedly fully repaid, and the period during which the Banks could make any such loans had long before elapsed (the agreement specifically provided that no such loans could be made after December 31st, 1943—R. 54) the joint venturers had neglected to formally revoke the assignment;

(d) It thus resulted that the Baltimore bank, as assignee-agent under the unrevoked assignment, received a Government check on December 6th, 1944 for $45,103.73, one half

of which it immediately delivered to the other joint venturer and one half ($22,551.86) it undertook then to apply against the remaining unpaid balances owing to it upon such old notes of the Bankrupt, guaranteed by the Messrs. Cummins.

In August, 1946 the Trustee requested approval of an alleged "compromise and settlement" by the terms of which:

(a) The Bankrupt estate would waive any claim, against the two Baltimore banks, that the application of the cash balances of some $68,500 on account of the Bankrupt's note indebtedness constituted a preference;

(b) The one Baltimore bank (which as assignee under the extinct though formally unrevoked assignment had obtained the Government payment of $45,103.73 on December 8th, 1944) would return to the Bankrupt estate $22,551.86 (being one half of such sum) which it had received under the circumstances hereinabove recited and had, within one month of adjudication, undertaken to apply to the old debts of the Bankrupt;

(c) The Bankrupt estate would then, in consideration only of such return (b), release any claims assertable against the Guarantors (Messrs. Cummins) who, within the four month period had thus obtained a $68,500 benefit (by reason of reduction of their liability as guarantors in that amount) when the two Baltimore banks applied the balances on deposit with them in reduction of the Bankrupt's indebtedness to such Banks.

Numerous creditors opposed such alleged compromise, in behalf of whom these Petitioners are acting.

NATURE OF THE PROCEEDINGS BELOW.

The Referee approved the alleged compromise.

On petition to review the Referee's Order the District Court, in effect, ruled:

(a) That under no theory could the Baltimore bank, which, as assignee, received the aforementioned $22,551.86, retain that collection;

(b) That such Bank must return such sum to the Trustee, and for its failure to do so sooner, it must in addition pay interest thereon;

(c) That although the Trustee could under all circumstances recover this sum, with interest, and though nothing more was offered as a consideration therefor, the Trustee was directed also to release the guarantors in the release to be executed in favor of the Banks by the Trustee.

On appeal the Circuit Court, in affirming, in effect, ruled:

(a) That the Baltimore bank, as such assignee, could under no circumstances retain such collection, and must therefore return that sum with interest to the Trustee;

(b) That though the guarantors are considered to be "*creditors*" within the meaning of the Bankruptcy law, and though within four months of the adjudication, with a knowledge of the Bankrupt's insolvency, obtained a *benefit* (when the Banks applied the balances on the note indebtedness guaranteed by them) by the reduction of their outstanding liability, a voidable preference did not result. The Circuit Court, observing that since an undecided question was here first presented, under the 1938 Chandler Act, ruled that, despite the enlarged meaning of "transfer" that term was still to be construed as it had been prior to 1938.

QUESTIONS PRESENTED.

I.

Where it is conceded that only the sum of money admittedly recoverable under any circumstances from the Baltimore bank is offered to the Trustee, should the Trustee, without any further consideration whatsoever, extend a release from the estate to four solvent, individual guarantors against whom the estate has (at the very least) a colorable claim for $68,500?

II.

Under section 60 of the Bankruptcy Act, regardless of the statutory right of set-off (permitted by section 68 between those having mutual debts or credits) allowed to the Baltimore banks, by which they applied the Bankrupt's balances in reduction of the note indebtedness, did not the guarantors, by reason of the enlarged scope and meaning of "transfer" enacted by the Chandler Amendment in 1938, obtain a benefit, which is a voidable preference?

III.

That since there is (at the very least) a colorable and prima facie claim against those four solvent guarantors for the benefit of the Bankrupt estate exceeding $68,500 (to recover which the objecting creditors have, with the consent of the lower Court, instituted action at their own expense but for the benefit of the estate), the Trustee should not, without any consideration whatever, be allowed to release the guarantors from such liability as the pending plenary action may establish.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The Circuit Court of Appeals for the Fourt Circuit has decided a question of Federal law of substantial and far reaching importance in the administration of the bankruptcy laws, which has not heretofore been presented or settled, but which should now be finally settled by this Court, to-wit:

(a) If a guarantor is a creditor within the purview of the Bankruptcy law, as is admitted by all parties, and accepted by the lower Courts in this case; and

(b) If such creditor, with knowledge of his own corporation's insolvency, within four months of its adjudication, receives a *"preference"* by which he benefits in consequence of the reduction of his guarantor's liability, as is admitted by the parties, and accepted by the lower Courts in this case; and

(c) If a *"preference"* is declared by section 60 of the new Act to be a *"transfer"*, which is expressly defined by section 1 (30) to include "the sale and *every other and different mode, direct or indirect,* * * * *of parting with property or with an interest therein* or *with the possession thereof* or *of fixing a lien upon property* or *upon an interest therein*, absolutely or conditionally, *voluntarily or involuntarily, by or without* judicial proceedings, *as a* * * * *payment*, * * *, *lien, encumbrance*, * * *, *security* or *otherwise"*, (Italics supplied), then:

(d) Has not such creditor (guarantor) as a matter of law obtained a voidable *preference*, under the *present* as distinguished from the *prior* Bankruptcy Act, when the Bankrupt's depositaries apply its bank balances upon such guaranteed note obligations?

Stated differently does not such application of funds by the Bank (called *set-off* under section 68 of the Act) represent in law:

(a) either an *indirect* or *involuntary*, or *some other or different mode*, of *"parting with property"*, or *"with an interest therein"* (i.e., the insolvents right to withdraw such balance by check or draft), "without judicial proceeding", or similarly;

(b) either *indirectly* or *involuntarily*, *"fixing a lien upon property or upon an interest therein, absolutely or conditionally"*, "without judicial proceeding", as "security or otherwise".

The opinion of the Circuit Court below, in this case, observed that the question projected here, has not been considered in any other case (R. 132).

2. It is essential that section 60, as amended in 1938 by the Chandler Act, and the meaning to be accorded to the term *"transfer"* in the greatly broadened scope and significance attributed to it by the new definition thereof adopted by the Chandler Act (section 1 (30)), be uniformly and authoritatively construed and applied throughout the United States for the guidance of all of the Courts.

3. The practical effect of the decision in this case is in conflict with the rationale of decisions in the 5th Circuit, (Walker vs. Wilkinson, 3 F. (2) 867 at 871), in the 2nd Circuit (Re: Schleicher Printing Corp., 62 F. (2) 503 at 504), and in the 8th Circuit (Paper vs. Stern, 198 Fed. 642), which were decided prior to and without aid of the expanded meaning of the term "transfer", upon the meaning and construction to be attributed to which term, under the Chandler Act of 1938, depend innumerable questions of law of constant and grave importance in the Courts. And which questions are currently receiving consideration in Congress.

CONCLUSION.

Wherefore your Petitioners respectfully pray that a writ of certiorari be issued under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fourth Circuit to review the order and judgment of that Court in the above cause; and that said Order and judgment be reversed; and that your Petitioners be granted such other and further relief as may seem proper.

Respectfully submitted,

NATHAN PATZ,
Attorney for Petitioners,
Baltimore Trust Building,
Baltimore 2, Maryland.

March 19, 1948.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. ------

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

A. RAYMOND MACHEN, TRUSTEE
in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

INTRODUCTORY.

I.

Reasonable comment would appear to warrant at least a passing reference to the strange position of the Trustee in Bankruptcy in this cause.

As both the District Court and the Circuit Court have declared that recovery from the Baltimore Bank, Assignee under the unenforcable though formally unrevoked assignment, of the $22,551.86 could not be denied, and as no

additional consideration whatsoever is received by the Trustee, it is difficult to appreciate the Trustee's insistence that this so-called "compromise and settlement" be consummated in order that the Guarantors be relieved of the necessity of responding to the claim that they have derived an avoidable preference in the amount of $68,500.00.

The Trustee, a close personal friend and sometime business associate of the Guarantors, cannot suggest that prosecution of the preference claim against the Guarantors might subject the bankrupt estate to needless cost and expense, since the objecting creditors, with the consent of the District Court, and at their own cost and expense (but for the benefit of the estate generally) have already filed and now have pending a plenary action against the Guarantors in respect of those claims. Ordinarily it would be expected that a Trustee in bankruptcy would not be so zealous as to come to the aid of challenged recipients of preferences.

It is an almost irresistible conclusion, drawn from the above, that the Trustee in this case in seeking, without possible gain to the estate, to free the Guarantors from the necessity otherwise of responding in the pending plenary actions filed against them, is indeed appearing for the Guarantors.

As the Circuit Court of Appeals said, and this statement will be helpful here in more readily defining the precise issue (R. 127):

> "The area of discussion will be much reduced if the position of the parties on certain questions, once at issue, but now in effect removed from the field of controversy, is first stated. The Trustee in bankruptcy although inclined at first to the opinion that reasonable argument, based largely upon the breadth of certain provisions in the collateral notes held by the Balti-

more National Bank, could be set up in support of the Bank's claim to the proceeds of the Government check, is now satisfied that the claim cannot be sustained. Furthermore, it is not now disputed that on October 16, 1944, when the banks took over the deposits, both they and the endorsers had reasonable ground to believe that the Construction Company was insolvent."

It would thus appear that the legal questions involved, important here and generally so in the administration uniformly ~~of the administration~~ of the Bankruptcy Act, present for determination authoritatively and finally a hitherto undecided and unsettled proposition of law.

But first, can the proposal, endorsed by the Trustee, which adds nothing to the estate beyond what is his for the mere request, be legally approved simply because it is termed a "compromise and settlement"? We ask: What are the Guarantors paying for this alleged compromise by the estate of a $68,500.000 claim against them? The answer, and it is the answer of both the District Court and the Circuit Court below, is: Nothing. Can any such arrangement, thus artificially and incorrectly designated, ever be anything more than what it is: a pure gift, by way of a full release without consideration of any kind, to the Guarantors?

The other and the far reaching legal proposition involves a fundamental interpretation of one of the basic sections of the entire Bankruptcy Act. It is a question which is novel and unique and not yet ruled upon by this Court. Do not the Guarantors (officers, directors or stockholders of a family corporation) receive a voidable preference when, with all of the ingredients otherwise requisite to such a holding present, they obtain or receive a $68,500.00 benefit (by reduction in that amount of their Guarantor's

liability to the banks) upon the application or set-off by the banks of the insolvent's cash balances against the note indebtedness of the corporation to the banks?

It is submitted that now, and since the 1938 Chandler Amendment, unlike the state of the law as it existed theretofore (which depended upon the earlier and narrow definition of the term "transfer"), such set-off by the bank is a preference in favor of the Guarantors, since the present act characterizes the term "transfer", for the purposes of identifying *preferences*, as including even the *involuntary*, the *indirect* and *every other and different* mode, whether with or *without judicial proceeding*, by which property or an *interest therein* or the possession thereof is changed (i.e., disposed of or parted with).

It has been observed that the earlier definition of the term "transfer" contained no reference to either of the signficant amendatory enlargements in the new definition, viz: an indirect or an involuntary or a non-judicial parting with an interest in property.

The petitioners most respectfully urge that when a depositary, holding bank balances credited and belonging to a customer, acts to apply or to set-off such balances against an indebtedness owing to it by such customer, that this act of the bank constitutes at least the involuntary parting, even though indirectly so, with an interest in property. Since 1938, any such parting with an interest in property is clearly and literally condemned where it benefits a creditor or guarantor) inasmuch as even "involuntary" or "indirect" acts or occurrences are comprehended by the express terms of the Bankruptcy Act.

Can it be soundly argued, as the respondent must here, that the right of the depositor in the bank balances held by his depositary—whether it be nothing more than a

chose in action—is not "an interest in property"? Entitled to be thus characterized is there not, when the bank so acts, at least an indirect or involuntary parting with such an interest in property, on the part of or away from the depositor?

See: N. Y. County Bk. v. Massey, 192 U. S. 138 at 145.

II.

The petitioners are not unmindful that the sheer bulk of applications for Writs of Certiorari imposes restriction upon the number and the nature granted. Nor are they unaware that the "open sesame!" into the realm of the Court is more ordinarily found in the statement that there is a conflict between the decisions of the Circuit Courts on a question. The petitioners respectfully submit that, although there is no precise ruling elsewhere upon the second question projected there is, in effect, a conflict in respect of the principles involved already apparent in the Circuit Courts. Moreover it is further respectfully submitted that the importance of the question and the opportunity to settle it finally merits an authoritative ruling by this Court in this case.

III.

ARGUMENT.

The matters set forth in the aforegoing petition are hereby adopted and respectfully made a part of this brief.

First Point.

Where it is conceded that only the sum of money admittedly recoverable under any circumstances from the Baltimore bank is offered to the Trustee, should the Trustee, without any further consideration whatsoever, extend a

release from the estate to four solvent, individual guarantors against whom the estate has (at the very least) a colorable claim for $68,500.?

The petitioners respectfully maintain that the outline of the proposition permits of only one answer.

The Trustee argues that the answer is: Yes.

The petitioning creditors contend that it is: No.

And referring to the introductory section of this brief and obeying the admonition of Rule 38 your petitioners limit discussion on this proposition thereto.

SECOND POINT.

A.

Under Section 60 of the Bankruptcy Act, regardless of the statutory right of set-off (permitted by Section 68 between those having mutual debts or credits) allowed to the Baltimore banks, by which they applied the Bankrupt's balances in reduction of the note indebtedness, did not the guarantors, by reason of the enlarged scope and meaning of "transfer" enacted by the Chandler Amendment in 1938, obtain a benefit which is a voidable preference?

B.

That since there is (at the very least) a colorable and prima facie claim against those four solvent guarantors for the benefit of the Bankrupt estate exceeding $68,000 (to recover which the objecting creditors have, with the consent of the Court, instituted action at their own expense but for the benefit of the estate) the Trustee should not, without any consideration at all, be allowed to release the guarantors from such liability as the pending plenary action may establish.

As these questions are essentially counterparts of the more basic issue presented for determination they are grouped here for ease of discussion.

Guarantors Are Creditors.

The District Court and the Circuit Court are agreed that Guarantors are deemed to be creditors within the meaning of the Bankruptcy Act (R. 65 and 131) for as the Eighth Circuit in Paper vs. Stern, 198 F. 642 long ago announced:

> "* * * The rule, however, is too well settled, and the reasons for it have been too often and too clearly stated, to warrant further discussion, that a guarantor, an endorser, an accommodation maker, or a surety on the obligation of a bankrupt is a creditor within the meaning of Sec. 60b of the Bankruptcy Act. * * *."

To the same effect are:

Cohen v. Goldman, 1 Cir., 250 F. 599;
In Re: Schleicher Printing Corp., 62 F. (2d) 503;
Collier on Bankruptcy, 14th Ed. Sec. 60.17;
2 Glenn, Fraudulent Conveyances and Preferences, 1940, Sections 460 to 462.

Banks' Right of Set-Off.

The right of the banks to apply or to set-off the balances arises *solely* by virtue of Section 68 of the Bankruptcy Act (USCA, Title 11, Sec. 108) and is wholly unconnected with and unrelated to Section 60 of the Bankruptcy Act (Section 96 of Title 11 of USCA) which condemns preferences and authorizes their avoidance by the Trustee.

The petitioners do not contend that the action of the banks on October 16, 1944, in acting to set off the balances in their respective banks against the bankrupt's note indebtedness, *insofar as those banks are concerned*, constituted an avoidable preference (R. 26).

But this result follows, not from any consideration of the provisions of Section 60 but, solely from the right of set-off conferred by Section 68.

Section 68 however applies exclusively between a bankrupt and a creditor having between them mutual debts or mutual credits. And in the absence of such debts or credits there is no right of set-off, even between a creditor and a debtor.

Section 68 provides:

> "Set-Offs and Counterclaims. (a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

The respondent contends that since the action of the banks in "setting-off" the balances against the bankrupt's obligations were not preferences to the Banks, that it follows as an inevitable and necessary corollary that the benefits obtained by the Guarantors as a result of the reduction of their liability is also not a preference.

The petitioners earnestly submit that the act of the banks is saved only and exclusively by the effect of Section 68 of the Bankruptcy Act, which permits the set-off, but limits it alone to *certain creditors*.

But since the Guarantors are not embraced in the class of creditors permitted a set-off by the terms of Section 68, it is accordingly submitted, that such Guarantors are not saved from the direct condemnation of Section 60 for they cannot escape by resorting to the insulation afforded only to the banks by Section 68.

It would appear clear, it seems to us, that without the protection afforded by Section 68 to the banks, that they

too would have obtained a preference within the meaning of the new Bankruptcy Act.

But in any event the Guarantors, having no recourse to the right of set-off created by Section 68—since they do not qualify as creditors holding the requisite claim at that time against the bankrupt—must defend entirely under the provisions of Section 60. Since, as we have observed, the present meaning of the term "transfer" embraces every conceivable occurrence by which any property, or any interest therein or right to possession thereof, is either voluntarily or involuntarily, directly or indirectly parted with, the Guarantors must be said to have received a preference.

The learned Courts below, in substance, have ruled that since the act of the banks in "setting-off" the bankrupt's balances cannot be said to constitute a preference in respect of the Banks themselves (which is so only because of Section 68), that the Guarantors of such obligations are also protected, somehow, by Section 68 (under which however they do not qualify as the kind of creditor entitled to the benefit afforded by the Section by way of set-off).

The petitioners most respectfully submit that such ruling is erroneous.

As announced, in reverse, by this Court in the case of Bank vs. Massey, 192 U. S. 138 at 147 in dealing with the matter there before this Court:

> "* * * But this does not, in our opinion, operate to enlarge the scope of the Statute defining preferences so as to prevent set off in cases coming within the terms of Section 68a. If this argument were to prevail, it would in cases of insolvency defeat the right of set off recognized and enforced in the law, as every creditor of the bankrupt holding a claim against the estate

subject to reduction to the full amount of a debt due the bankrupt receives a preference in the fact that to the extent of the set off he is paid in full."

Paraphrasing that pronouncement, the petitioners contend that Section 68 does not operate to restrict the scope of Section 60 so as to relieve against preferences in cases coming within the terms of Section 60 and in respect of creditors who are not entitled to the direct right of set-off afforded only by Section 68.

We respectfully submit that the obvious benefits received by the Guarantors in this case (passing for the moment the additional fact that they were officers, directors or stockholders of the bankrupt), unprotected and not covered by the provisions of Section 68, are nothing less than a voidable preference under Section 60.

The Chandler Act.

By its adoption in 1938 Congress following prolonged study drastically revised and amended the then existing Bankruptcy law. The changes made were not haphazardly or unwittingly accomplished. Those changes were studiously intended.

In his foreword to the volume "The Bankruptcy Law of 1938—Chandler Act", authored by Jacob Weinstein and prepared for the National Association of Credit Men, Honorable Walter Chandler, M. C. and Sponsor of the Act, declared:

> "Every section of the Act of 1898 was analyzed, and the applicable decisions of construction were reweighed in the light of rapid and far-reaching economic and social changes. Consequently, the amendments to the first seventy-two sections are the result of clear proof of defects and inadequacies."

And the author of the volume in his commentary on page 7 says:

> "This definition, '(25)' of the old Act, has been retained in the Chandler Act, but has been amplified to make it clear that the term 'transfer', as used in the Act, covers every conceivable form or method of transfer of property, interest therein or the possession thereof. * * *"

The Circuit Court below felt impelled to adhere to its earlier rulings, all made prior to the 1938 amendment, in the cases of Citizens' Nat. Bank of Gastonia, N. C. v. Lineberger, 45 F. 2d 522, 527 and Drugan v. Crabtree, 299 F. 115, 119-120.

Those cases were decided at a time when the Bankruptcy Act could not reach benefits received by creditors as a result of either *indirect* or *involuntary* parting or separation from interests in property, which was first permitted and indeed required by the Chandler Act of 1938.

It is interesting to observe that notwithstanding the limitations inherent in the earlier Act one of the Circuit Court Judges in a dissent to Citizens National Bank vs. Lineberger, supra, at page 532 said:

> "* * * The result of the seizure of the deposits in the Bank, when negotiations for a settlement failed, was undoubtedly a preference to these solvent endorsers and not to the Bank * * * The result was that assets of the Bankrupt Company were used to pay debts for which Kirby and Warren (the guarantors in the case) were liable, and the assets of the Bankrupt were diminished in the amount * * *."

The Circuit Court in this cause ruled, after agreeing with the petitioners' contention that the Trustee in Bankruptcy was receiving nothing whatever for the release to the Banks and to the Guarantors beyond what the Trustee was

entitled to receive from the Banks alone, that the term "transfer" although broadened by the 1938 amendment, is, in respect of one class of creditors (i.e. guarantors of bank held obligations), yet to be construed as if it had not been so broadened. The Court, as the predicate for such construction, refers (R. p. 132) to the legislative history of the Chandler Act in respect not of Section 60 (preferences) but that of Section 68 (Set-Off).

The Circuit Court apparently reached its final conclusion because amendments which were offered in Congress to the set-off provision in Section 68 of the Act and which would have altered the recognized rule with regard to the right of set-off failed to secure adoption; the Circuit Court then added:

> "* * *; and that although these amendments received considerable support, they were rejected by Congress; and hence it is clear that although the term 'transfer' has a wider significance as used in Section 60 than formerly, Congress had no intention of altering the accepted law as to bank deposits. * * *" (R. 132).

The Circuit Court cites Collier on Bankruptcy (14th Ed.), (as authority for this conclusion as to the legislative intent), Vol. 4, Sec. 68.01, p. 705 (R. 132), see also: Collier, Vol. 3, Sec. 60.15, pp. 805-806).

It will appear by reference to such citations that the suggested modifications which Congress did not finally accept related alone to and dealt entirely with the matter of restricting the rights of *Banks* to set-off under certain circumstances. The amendments thus proposed to Section 68 intended (by such amendments) to eliminate the right of Banks to obtain or achieve set-offs *for themselves.*

The proposed amendments to Section 68 consequently had no bearing upon Section 60, the effect of which in the

future characterization of "preferences" (or "transfers") was drastically and significantly *enlarged* by reason of the expanded definition of "transfer", then incorporated.

The learned Circuit Court, it is respectfully submitted, veered toward its final decision because of its conclusion that the failure of Congress to adopt the proposed amendments in respect of Section 68, the effect of the adoption of which would have only meant that Banks under certain circumstances could lose their right of set-off, nullified the affirmative action of Congress in distinctly and sharply enlarging the impact of Section 60. This we respectfully submit is erroneous. There admittedly was a legislative change made in the scope of Section 60, which calls for consequent change in its construction.

Equality Is Equity.

This Court has repeatedly declared that Courts of Bankruptcy are essentially Courts of Equity (see the very recent language of Mr. Justice Murphy in United States Bank vs. Chase Bank, 331 U. S. 28 at 36). And that creditors in the Bankruptcy Courts are to receive an equality of treatment, and distribution (Sampsell vs. Imperial Paper Corp., 313 U. S. 215 at 219).

Yet, the effect of the ruling below is to disrupt that equality of treatment and to favor one class of creditor at the expense of another. Since the Guarantors involved in this cause are creditors within the meaning of the Bankruptcy Law along with all other Guarantors, endorsers or sureties, they ought to have no greater right than is afforded under the new Bankruptcy Act to Guarantors of species of obligations other than a bankrupt's indebtedness to a bank.

Guarantors Received A Preference.

There have been many cases in which endorsers or guarantors, even without knowledge of the bankrupt's payment on account of the guaranteed obligation, have been held to have obtained preferential benefits in consequence of which they have been forced to return the amount of the benefits to the bankrupt estate. Many of these were decided prior to the broadening effect upon this subject of the 1938 amendments.

In Walker vs. Wilkinson, 3 F. (2) 867 at 871 (5th C. C. A.-1925) it was said in a suit by the Trustee against a guarantor:

> "* * * The appellant, the President of the bankrupt and the surety or guarantor of its liabilities to the bank, with knowledge of its insolvency, within four months prior to the filing of the bankruptcy petition, brought about the payment of $32,500.00 on liabilities of the bankrupt to the bank, whereby he was benefited in the amount of such payment; he at that time having reasonable cause to believe that such payment would effect a preference. A result was that a preference arose, the amount of which was recoverable from the appellant by the appellee, the trustee in bankruptcy * * *" (And the Court in this case allowed interest on the recovery.)

And In Re: Schleicher Printing Corporation, 62 F. (2) 503 (1933-2nd CCA) it was said at page 504:

> "* * * From the language used it is clear that the person receiving it need not be the one to be 'benefited thereby', and equally clear since the amendment of 1910, that, if the one to be benefited has reasonable cause to believe that a preference will be effected the transfer is voidable. * * * It should be noted, that in

Paper et al. vs. Stern, supra, the transfer was held voidable even though the guarantor did not induce the payment of the debt. * * *."

See also:

Swarts vs. Siegel, 117 F. 1, 13 (8th CCA);
Goldman vs. Cohen, 261 F. 672 (1st C.C.A.-1919);
Colliers 14th Edition of the Work on Bankruptcy, Vol. 3, p. 811, Sec. 60.17.

It has therefore been uniformly held that a guarantor or endorser receives a voidable preference on the occasion when the bankrupt's indebtedness so guaranteed or endorsed, is reduced or discharged.

And that this result must be reached even though the guarantor or surety neither induced the payment or discharge nor knew thereof.

In the cause at bar it is equally evident that the Guarantors received a preferential benefit; though of course since they were in active control of the bankrupt and now admitted to have had prior knowledge of its insolvency (or better than reasonable cause to believe that the debtor was insolvent) these Guarantors may also be said to have induced or brought about a situation, by continuing to make deposits in the Banks holding the bankrupt's indebtedness guaranteed by them, as a result of which they obtained these benefits. But as ~~interest~~ intent of the petitioners is no longer important in the law of "preferences", refer to this phase of the case only in review.

As the Guarantors were unentitled to the right of a creditor authorized to set-off under Section 68 the petitioners respectfully contend that they obtained an avoidable preference. And that, while the deposits in the Banks did not in and of themselves *constitute a parting with property or its possession* the *action of the Banks*, subse-

quently, in *setting-off those balances* gave rise to an *involuntary and indirect parting by the bankrupt* (or visited upon the bankrupt) *of an interest in property*, viz: those banks balances. It is therefore these events, and not the original deposits in Bank (which under the prior Bankruptcy Act produced the decisions in Bank vs. Lineberger, 45 Fed. (2) 522, 527 and Drugan vs. Crabtree, 299 Fed. 115, 119-120, supra), which since 1938 are to be stamped as the events giving rise to a voidable preference, viz: the involuntary or indirect parting from the bankrupt of an interest in property or the right to possession thereof.

CONCLUSION.

It is respectfully submitted that, because of the specification of errors below, the petition for the Writ of Certiorari should be granted so that the plenary actions may be tried.

NATHAN PATZ,
Attorney for Petitioners,
Baltimore Trust Building,
Baltimore 2, Maryland.

March 19, 1948.

FILE COPY

Office - Supreme Court, U.S.
FILED
APR 23 1948
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 684

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

A. RAYMOND MACHEN,
Trustee in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

PETITIONERS' REPLY BRIEF

NATHAN PATZ,
Attorney for Petitioners,
Baltimore Trust Building,
Baltimore 2, Maryland.

April 22, 1948.

The Daily Record Co., Baltimore 3, Md.

INDEX

	PAGE
PETITIONER'S STATEMENT OF FACTS RE-EXAMINED	1-6
THE BANK CANNOT RETAIN THE ASSIGNED FUNDS	6-8
CONCLUSION	8-9

TABLE OF CASES

Grandison v. Bank, 231 F. 800 at 804-06	2
Prudential Ins. Co. v. Nelson, 96 F. (2) 487 at 490	2
Seims Constr. Co., D. C., Md. 1941, 37 F. S. 855	8

TABLE OF STATUTES

U. S. C. A., Title 41, Sec. 15 (1940 Act: Assignment of Claims)	7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 684

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

A. RAYMOND MACHEN,
Trustee in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

PETITIONERS' REPLY BRIEF

I.

Petitioners' Statement of Facts Re-Examined

The respondent devoted a considerable portion of his brief to a denunciation of the Petitioners' statement of facts. And instances alleged misstatements therein.

Without fencing with our adversary the Petitioners reaffirm their statements of fact and without too extensive a reply respectfully offer the following observations.

Respondent (his brief at page 20) challenges the statement that the bankrupt concern had for months prior to its adjudication "ceased to function as an active and going

concern". But does the Trustee deny that for many months the concern had failed, in the ordinary course of business, to satisfy and discharge its creditors? Or does the Trustee deny that some four hundred thousand dollars, plus, of long overdue claims have been filed in this case? Does this known failure to discharge delinquent claims by this bankrupt, over a period of many months prior to its adjudication, constitute its functioning as a going concern? These are facts. The Trustee knows them to be facts. Why therefore should we have his cavil concerning such a statement?

Again, at page 22 of his brief, the Trustee, though careful not to deny that a large Government contract had been terminated,—indeed, the Trustee now supplies the date of termination,—protests that we somehow improperly stated "a large Government contract had been earlier terminated." This too was a fact. The Trustee and his counsel know it to be a fact, just as they know how much, or how little, was collected on the alleged claims of $400,000 to $500,000, asserted by the Bankrupt by reason of such termination by the Government (see page 4 of respondents brief).

The Courts long ago discarded the unwarranted attachment of inflated value by a bankrupt to a disputed claim in considering the insolvency of a company. Anyone at all can *assert* a claim; that does not impart value to it however.

See: Prudential Ins. Co. v. Nelson, (6th CCA), 96 F. (2) 487 at 490;
Grandison v. Bank, (2nd CCA), 231 F. 800 at 804-06.

Thus it was that the elimination of these repudiated claims against the Government—the officers are certainly to be charged with a knowledge of and familiarity with the affairs of their company—disclosed the clear bankruptcy

of the Company. Still the Trustee objects to the statement of the Petitioner that the company had ceased to function as a going concern and that the Government had earlier terminated a large contract. And yet both are correct statements of fact.

At page 23 of his brief the Respondent complains that in the course of argument by the Petitioner upon the proposition that the Guarantors, who were in active control of and operating the bankrupt firm, received a preferential benefit, it was said:

> "* * * though of course since they were in active control of the bankrupt and now admitted to have had prior knowledge of its insolvency (or better than reasonable cause to believe that the debtor was insolvent) these Guarantors may also be said to have induced or brought about a situation, by continuing to make deposits in the Banks holding the bankrupt's indebtedness * * *."

The Trustee's reply brief says that so much of this argument as infers that the Respondent made any such admission is incorrect. Reference to the opinion of the Circuit Court of Appeals (R. p. 127) is sharply illuminating; of course it must be remembered that this opinion was written after oral argument made in behalf of counsel for the respondent, during which the Court asked certain questions and received certain answers. The Court in its opinion, said:

> "The area of discussion will be much reduced if the position of the parties on certain questions, once at issue, but now in effect removed from the field of controversy, is first stated. * * * *Furthermore, it is not now disputed that on October 16th, 1944, when the banks took over the deposits, both they and the endorsers had reasonable ground to believe that the Construction Company was insolvent.*" (Italics supplied.)

Evidently not only counsel for the Petitioners, also present at the oral argument, but the Court itself, was made to realize that this fact was no longer in dispute.

In much the same vein we find Respondent (his brief, page 23) challenging the statement that the officers (Guarantors also) continued to make deposits in these banks in the weeks prior to October 16th, 1944, though they also maintained a third depositary, to which Bank the company was not indebted.

The Respondent, though hesitantly, suggests that it is inaccurate to make this statement, since an assistant treasurer physically made the deposits. The Respondent quickly recognizes however that "there can perhaps be no doubt that Mr. Hart would have obeyed instructions"; the Petitioner reiterates the proposition that the management and supervision of a close corporation of the character here involved, owned by the Guarantors as stockholders altogether, and alone directed by its officers is necessarily an intimate one, and the Officers and Directors cannot escape the responsibility that follows from their actual and constructive knowledge of the affairs and status of their company.

Still again the Respondent lectures that the Petitioner somehow is guilty of another misstatement by referring to the Guarantors as officers, directors and stockholders. The fact is that the Guarantors are either officers, directors or stockholders. At least three of the four are (would it be fair to say 'admitted' to be) officers and directors. And on page 3 of the Petitioners' brief in support of the Petition for a Writ, it was stated only that:

> "* * * Do not the Guarantors (officers, directors *or* stockholders of a family corporation) receive a voidable preference when, * * *". (Italics here supplied).

And again, for an illustration, the Respondent challenges the statement that the Petitioners are acting for creditors opposed to the alleged compromise. Instantly though the Respondent (at page 26 of his brief) recognizes that, if successful, the action taken by the Petitioners will benefit *all creditors*. Actually, as the Trustee knows, there is a pending suit, filed by the Petitioners, at their own cost, but for the benefit of *all creditors*, for recovery of the claimed preferential benefits received by the Guarantors. Counsel for the Petitioners, and the Respondent knows this to be a fact, has filed in the Court below powers of attorney from numerous creditors opposed to the alleged compromise; is there need to parade all of them before this Court as petitioners when one of their number will suffice.

And finally without further elaboration it appears that the Respondent (on page 27 of his brief) decrys the Petitioners statement that the Trustee is "a close personal friend and sometime business associate of the guarantors."

Nothing would be more simple to establish.

All of which the Trustee quite well knows.

The Respondent refers to a passage of the transcript in the record (R. pp. 107-108) and apparently accepts that as substantiation of the statement that the Trustee is "a close personal friend" of the guarantors. There is no need to belabor the conclusion; that is the testimony of one of the Guarantors, the President of the bankrupt; and certainly that is more than borne out by the mere circumstance of the Trustee's presence at the Banks on the occasion described. Mere creditors were not present!

But, asks the Respondent, is there any basis, in the record, for identifying the Trustee as a "sometime business associate" of the guarantors?

Does the Trustee deny the accuracy of the following statement, which appears in the Record. Can he dispute—as a matter of fact—what is mirrored here:

> "* * * and this case started from the very first meeting of creditors where we asked that the trustee who was appointed be disqualified *because of his friendship with the endorsers in this case who were in his employ,* and he had undertaken his (their) outstanding contract (R. p. 44). * * *" (Italics supplied).

As a matter of fact the Trustee cannot deny that he and the guarantors or some of them have been associated in business together!

Where is the warrant then for the disputatious tenor of the Respondent's brief?

II.

The Bank Cannot Retain The Assigned Funds

Elsewhere in his brief the Respondent (at pages 7 and 8) resurrects two rejected contentions. The first, that the language of the notes held by the Bank from the bankrupt could support that Bank's attempt to retain the proceeds which it received, within one month of adjudication, under the old unrevoked (but no longer effective) assignment which had been executed in 1942. The language of the notes (and they appear at Record pages 45-48)—without defining with any certainty the assets referred to—distinctly provides for application by the Bank toward the indebtedness at the *maturity* of the note of only "* * * moneys, stocks, bonds or other securities or property * * * on deposit with or held by, or in the possession of said bank, * * * or in transit to or from the bank by mail or carrier, * * *".

No part of the $45,103.73, one half of which the Bank attempted to apply on or about December 6th, 1944, was either on deposit with or in the possession of the Bank or in transit to it when any of the notes matured, and the last one of the three matured on October 25th, 1944.

Moreover *each of these three notes*, which the Trustee suggests may be employed as transferring to the Bank a still further right (beyond that of the old and no longer effective 1942 assignment itself) to obtain the $45,103.73 as collateral, *were executed within four months of the adjudication.*

These notes represented old obligations of the bankrupt only. They would in and of themselves be preferences if any such effect might be claimed by the Bank for them.

Moreover, any attempt by the provisions appearing in said notes to accomplish a further assignment of the Government proceeds was ineffectual (and unintended) since the Federal Statute permitting assignments of contract claims required the formal recording of all such assignments with the requisite Federal Agencies (which was not attempted in respect of these notes); and since each of the notes are dated within the four month period any attempt thereby to assign further security for the repayment of then outstanding loans would be condemned as a distinct and independent preference. Any such attempted assignment of the Government funds, since it *was not perfected by the required recording with the Federal Agencies its provisions* would be nugatory, if sought to be applied to the Government funds payable under the Cedar Point contract.

USCA, Title 41, Sec. 15 (1940);

See also:

RE; Seims Constr. Co. D.C., Md., 1941, 37 Fed. S. 855;
Authorities cited in the District Court opinion, R. p. 69;
Circuit Court opinion thereon, R. p. 127.

The second of the resurrected contentions (Respondent's brief at pages 7 and 8) now suggests that (1) although the express terms of the assignment in 1942 of such anticipated Government contract payments were limited so as to secure repayment only of loans made exclusively for the Cedar Point project, and (2) all such loans had been fully satisfied, — — the Bank is not prohibited "from retaining the assignment for another purpose."

As the clear facts in this case unqualifiedly disclose, to quote the language of the District Court opinion, it must be held:

> "From the facts existing at the time this fund was received by the bank, that the bank had no right to retain this money, except as in the nature of an agency or trust account for the bankrupt, seems beyond question. As explained previously herein, the contract with the Government had been terminated for the convenience of the latter in 1943, and all sums due the bank by the bankrupt and its co-contractor on account of the loan obtained from the bank for the purpose of completing the Government project, had been paid by September, 1944." (R. p. 67).

CONCLUSION

The Petitioners would have preferred to forego the presentation of this reply brief, but in view of the unfounded comment of the Respondent regarding the earlier statement of facts, it was considered desirable that this reply thereto be formally submitted.

And the Petitioners again respectfully submit that clearly analyzed the really pivotal matters of facts here involved are so free of dispute as to be virtually stipulated.

Without citing any authority whatsoever the Respondent, though offering no objection to the grant of the requested writ of certiorari on the question numbered "(2)", protests its grant as to the other important questions propounded. The Petitioners most earnestly and respectfully urge that the Court grant the writ upon all of these far-reaching questions, and not alone as to the one to which the Respondent offers no objection.

Respectfully submitted,

NATHAN PATZ,
Attorney for Petitioners,
Baltimore Trust Building,
Baltimore 2, Maryland.

April 22, 1948.

FILE COPY

Office - Supreme Court, U.S.
FILED
APR 9 1948
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 684

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

S. RAYMOND MACHEN, TRUSTEE
in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

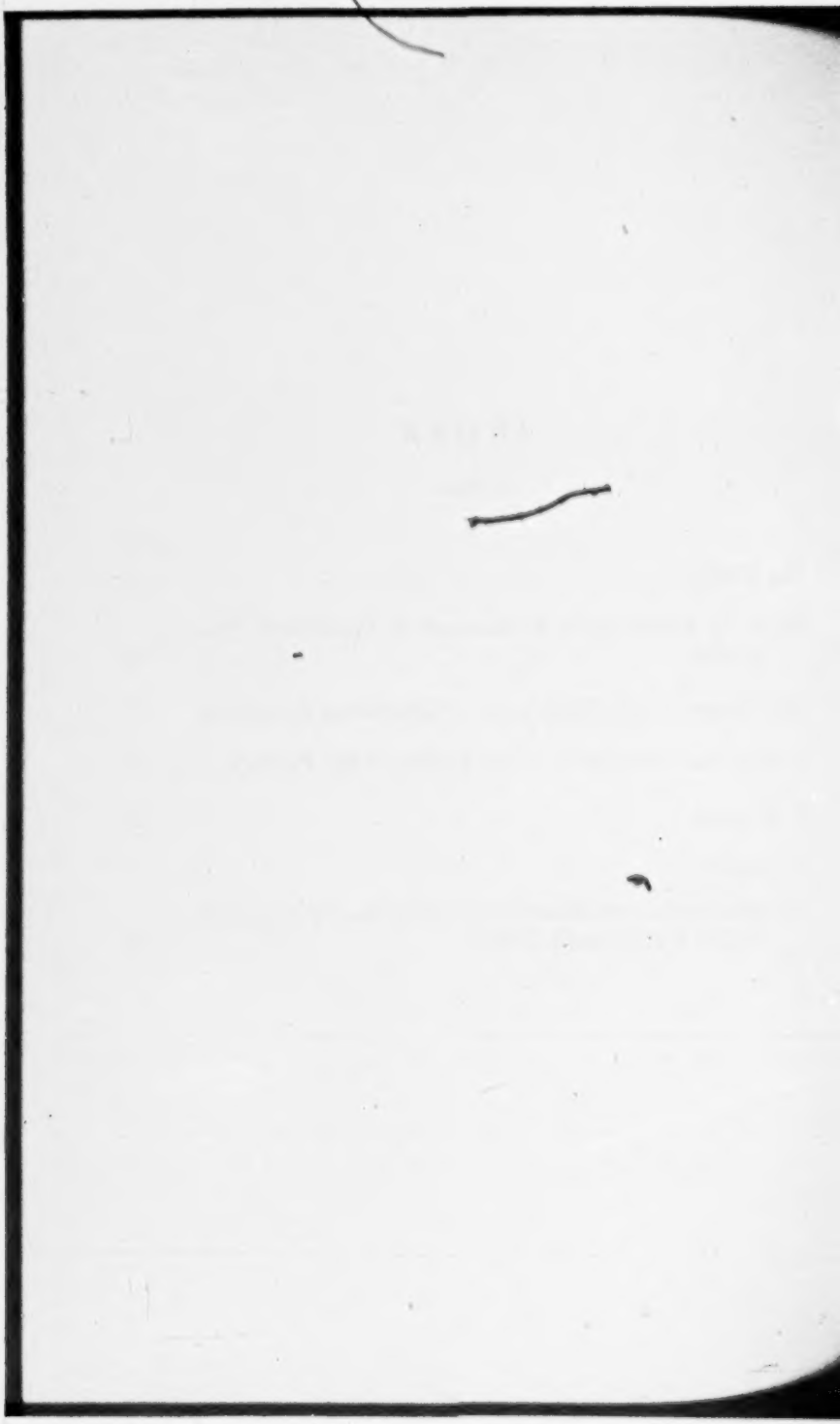
BRIEF IN RESPONSE TO PETITION FOR WRIT OF CERTIORARI

FREDERICK J. SINGLEY,
CHARLES G. PAGE,
Attorneys for S. Raymond Machen, Trustee in Bankruptcy of Cummins Construction Corporation.

The Daily Record Co., Baltimore 3, Md.

INDEX

	PAGE
The Facts	2
Error in Petitioner's Statement of Questions Presented	13
The Respondent's Statement of Questions Presented	17
Respondent's Position on the Merits of the Petition	17
Conclusion	18
Appendix:	
Inaccuracies and Misstatements in the Petition and in the Petitioner's Brief	19



IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. ------

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

VS.

S. RAYMOND MACHEN, TRUSTEE
in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

BRIEF IN RESPONSE TO PETITION FOR WRIT OF CERTIORARI

This case was initiated by a petition of S. Raymond Machen, Trustee in Bankruptcy of Cummins Construction Corporation, for authority to enter into a compromise settlement. After a hearing before the Referee, an order was entered ratifying and approving the settlement (R. p. 14). Petitioner appealed and the District Court approved and confirmed the compromise settlement subject to certain modifications with regard to interest (R. pp. 70-72). The Petitioner then took a second appeal to the Circuit Court of Appeals, which affirmed the District Court

(R. p. 133). Petitioner filed an application for certiorari which was served upon Respondent on March 22nd, 1948. This brief is a response to the said petition and the brief which was attached to it.

THE FACTS

Respondent is not satisfied with Petitioner's statement of facts, and therefore has made a complete restatement. Petitioner's statement is considered in detail in the Appendix.

Prior to bankruptcy, the Cummins Construction Corporation was engaged in substantial construction operations. It was declared a bankrupt on January 4, 1945. The offer in compromise involves transactions which occurred on two dates, both of which were within four months of bankruptcy, to wit, October 16, 1944, and December 6, 1944.

The details of these transactions are set forth in the petition of the Trustee (R. p. 1). On October 16, 1944, the bankrupt was indebted to the Baltimore National Bank on three notes in the amount of $70,000.00. It carried checking accounts in the said bank in the amount of $14,628.76. One of the notes, in the amount of $25,000.00, was to mature on that day.* On the same day, the bankrupt was indebted

* An omission and a typographical error in the Petitioner's Appendix which is repeated in the reprint for this Court (Record 46) should here be noticed. The note here referred to was Trustee's Exhibit No. 5, Sheet 7, a photostat of which appears in the transcript at page 216. The Petitioner's Appendix reprints this note but the date is incorrectly printed "Sept. 11, 1944" rather than "Sept. 14, 1944" as will appear by reference to the photostat. Also the words "Due Oct. 16" which are written in ink above the date on the photostat are omitted. The explanation of the due date is of course that thirty days from September 14th, 1944, was a Saturday, and by statute the note came due on Monday, October 16th. (See Maryland Code, 1943 App., Article 13, section 11.)

on four demand notes to the First National Bank of Baltimore in the amount of $125,000.00; and it carried in its checking accounts at the said bank $53,887.29. The indebtedness to both banks was guaranteed by Albert S. Cummins, President, John R. Cummins, Vice-President, Harold N. Cummins, Secretary, of the Cummins Construction Corporation, and by C. A. Cummins, father of Albert and John Cummins. Mr. C. A. Cummins was not an officer of the corporation, nor was he active in its management (R. pp. 88, 121).

A substantial amount of evidence was taken with regard to the nature of the checking accounts which were carried in each bank. Counsel for the Petitioner was invited to, and did, participate in this hearing, and the officers of the bankrupt were examined under oath. The bank statement sheets of the respective accounts were produced and the corporation's accountant, who was assistant secretary-treasurer, was examined regarding them (R. p. 2 et seq).

On appeal, the Trustee printed a portion of the testimony, relating to the deposit accounts carried at the Baltimore National Bank and the First National Bank as part of his appendix below, and the same is reprinted here. The testimony was thus made available (by the Trustee not the Petitioner) for the reviewing court to determine whether there was substantial evidence to support the findings of fact of the Referee and of the lower courts. However, in the absence of specific analysis of the evidence by the Petitioner calling for more detailed treatment by ourselves, we, for the purpose of the present statement of facts, will merely quote from the findings of the Referee with regard to the manner in which the accounts were maintained and deposits made. The Referee found:

> "The testimony definitely shows that the funds constituting these balances were deposited in due course

> of business, that no attempt had been made to build up these balances and no restrictions had been placed on the withdrawal thereof. Neither is there anything in the evidence to show fraud or collusion between the banks and the bankrupt corporation, or between the banks and the guarantors of the notes." (R. p. 19)

This finding was approved by both lower courts (R. pp. 66, 127-8).

The Seizure of the Deposits

On October 16, 1944, the corporation was in need of money. A $25,000.00 note was to come due on that day to the Baltimore National Bank.* The solvency of the corporation depended upon the validity of a number of Government claims which totalled between $400,000.00 and $500,000.00 (R. pp. 84-5; 29). These had been regarded as meritorious by the officers (R. pp. 106-7; 113-4; 116-8) and looking forward to the maturity of the above mentioned $25,000.00 note to the Baltimore National Bank the amount of the claims had been included in a balance sheet which had been prepared for presentation to the bank upon application for renewal of that note (R. p. 106). On the morning of that day, Mr. Lanham, who with Mr. Frost (both of Washington) had been employed to prosecute the claims (R. p. 120), came to Baltimore and informed the officers that he could get no money from the Government at that time, and of the probability of an extended delay in payment (R. pp. 107-8).** After the dis-

---

* This note was renewal of a thirty-day note apparently given on August 15, 1944, for a new loan made at that time (R. pp. 96-7). The method of renewals is explained at R. p. 105. Renewals up to October had apparently been pretty much a matter of course by telephone (R. pp. 103-4).

** The first payment on account of claims thereafter was on the Cedar Point contract on December 6, 1944, in the amount of $45,103.73. That payment is involved in the present settlement and is discussed hereafter.

cussion with Mr. Lanham, Mr. Albert Cummins telephoned to the Baltimore National Bank and then went down to see Mr. Miles, Chairman of the Executive Committee of that bank, and explained the situation to him (R. p. 108). The purpose of the visit was to obtain additional money to tide the corporation over (R. pp. 111-2; 105-8). He took with him Mr. Lanham, and Mr. S. Raymond Machen, present Respondent, who is and was President of the Baltimore Steel Company. It was testified that the Baltimore Steel Company was the largest creditor (R. pp. 107-8).* Mr. Miles was not sympathetic to the application but agreed to wait upon a decision by the First National Bank as to what action should be taken (R. pp. 108-9), and Mr. Cummins, Mr. Lanham and Mr. Machen thereupon set out for that bank (R. pp. 109-110). Upon learning the facts, the First National Bank thereupon called its notes and impounded the deposits in its hands (R. pp. 110-111). The Baltimore National Bank thereupon also impounded the deposit in its hands and applied it against the indebtedness of the $25,000.00 note due on that day (R. p. 111).

The first of the claims involved in the settlement arises out of the action of the banks in impounding the deposits carried against the indebtedness due them. Petitioner disclaims any suggestion that the banks obtained voidable preferences by seizing the deposits as aforesaid (Petitioner's brief p. 7), but claims that the action of the banks in so doing, resulted in preferences to the guarantors.

The $45,103.73 Check

The other transaction giving rise to the settlement arises out of the receipt by the Baltimore National Bank on

* Though the Record does not show it, this statement is not strictly accurate as the indebtedness to one of the banks exceeded that of the Baltimore Steel Company. The comment referred to the largest general creditor.

December 6, 1944, of a check from the Treasurer of the United States, payable to its order as assignee, in the amount of $45,103.73. The details are stated in the Trustee's petition (R. p. 1). The check was delivered under the following circumstances: In 1942 the bankrupt, as joint venturer with Riggs Distler and Company, Inc., a Maryland corporation, had entered into a contract with the United States of America known as Contract NOy-5363, for construction and installation of certain facilities at Cedar Point, Maryland. The joint venturers thereafter executed a loan agreement, and in pursuance thereof an assignment of amounts to become due under said contract to the Baltimore National Bank, to hold as security for certain loans then or thereafter to be made by the Baltimore National Bank and others to the joint venturers. Notice of said assignment was duly filed and acknowledged by the Bureau of Yards and Docks of the Navy Department of the United States on November 24, 1942, (R. pp. 95, 96). Thereafter funds were lent to the joint venturers on account of the said contract. Early in 1943 (R. p. 22) the contract was terminated and in due course all loans which had been negotiated by the joint contractors from the Baltimore National under the loan agreement were paid (R. p. 22). Notwithstanding this, the said loan agreement was never rescinded and funds payable on account of said Contract NOy-5363 to the joint venturers were thereafter paid, as was the above check of the Treasurer of the United States, to the Baltimore National Bank as assignee (R. p. 22). In the meanwhile, the bankrupt had become heavily indebted to the Baltimore National Bank for funds (not involved in the joint venture) and, as above stated, the bankrupt was on October 16, 1944, indebted to the Baltimore National Bank on three notes in the amount of $70,000.00, which balance was reduced on that day, by

seizure of the deposits on hand, to $55,371.24. Each of the notes, which were on printed forms, contained the following provision:

> "At the maturity of this note any and all moneys, stocks, bonds or other securities or property of any nature whatsoever on deposit with or held by, or in the possession of said bank, as collateral or otherwise, to the credit of or for account of the makers, endorsers or other parties hereto, or either or any of them, or in transit to or from the bank by mail or carrier, may be applied forthwith to pay or secure payment of this note or any other indebtedness due said bank by said parties * * *" (R. p. 47).

All the notes had matured prior to December 6, 1944.

Upon receipt of the above mentioned check in the amount of $45,103.73, the Baltimore National Bank, on December 6, 1944, cashed the same and, after delivering one-half thereof to Riggs Distler and Company, Inc. (the joint venturer), applied the other one-half thereof, or $22,551.86 (as the bankrupt's share), against the bankrupt's indebtedness to it (R. pp. 3-5).

It should here be noted that although the assignment was originally obtained by the bank for purpose of securing itself and the syndicate represented by it on account of loans made on the Cedar Point construction project, there was no provision, either in the agreement or in the assignment, specifically prohibiting the bank, after repayment of the loans and the expiration of time for making new loans, from retaining the assignment for another purpose. This comment is made because of the misstatement in the Petitioner's summary statement of the case (at page 5) that by the assignment—

> "sums payable under the joint contract would be paid to the Baltimore bank, as agent, *only* to secure repay-

> ment of the unpaid loans to be made by the bank to the joint venturers for use *only* in the joint undertaking."

Unfortunately there is no copy of the assignment in the printed Record nor is there any copy of the loan agreement, although Petitioner did include an excerpt from the latter (R. p. 52). An excerpt from the assignment is quoted by the District Court in its opinion (R. p. 68). The importance of this omission was understood by this Respondent only after reading the Petitioner's allegations under paragraph "(b)" at page 5 of the summary statement. It should be noted that the Petitioner's comment is unsupported by reference to any part of the Record.

From what has been said, it is apparent that the bank held the $22,551.86 for the benefit of the bankrupt; and it was apparent that the bank was in the position to insist that, by reason of the terms of its notes, then overdue, it was entitled to hold and apply the same to the bankrupt's indebtedness to it. The validity of this position would depend upon whether the bank could establish a lien upon the funds included in the assignment which would extend back of the four-months' period prior to bankruptcy. The Trustee took the position that the application of the $22,551.86 to the indebtedness of the bankrupt constituted a voidable preference. On the other hand, the Baltimore National Bank denied liability and claimed that its action was justified in the premises. While a full discussion of the reasons for its action has never been had with the Baltimore National Bank, the Trustee anticipated possible defenses raised, (1) with regard to the question of notice of insolvency and the actual fact of insolvency at the time of the application of the amount; (2) a claim by the bank that it was entitled to a lien upon the fund either because of the aforementioned assignment or because of the terms

of the notes held by it, which purported to give the bank a lien; or (3) because of a banker's common law lien, or because of a combination of these rights. (And see offer of compromise R. p. 6 and 7). The claim of the bank to a lien, if one existed, would extend to other funds ultimately paid on the Cedar Point contract claim.

The District Court considered the bank's position in its opinion (R. pp. 66-69). It is sufficient here to say that the Trustee was (and is) advised by his counsel that substantial questions of law and fact could be raised in defense against the Trustee's demand for return of the said sum, and that in the absence of a compromise the bank would litigate its liability with regard thereto.

The Agreement with Charles A. Cummins Dated December 8, 1944

One other transaction must be considered. Charles A. Cummins was one of the guarantors. He was the father of Albert Cummins, President, and John Cummins, Vice-President, and related to Harold Cummins (who together constituted the guarantors). Mr. Cummins had for some time ceased to be an officer and did not actively participate in the affairs of the bankrupt (R. pp. 88, 121). After the freezing of the bankrupt's deposits, and in response to a demand by the banks, he and his wife undertook to make a partial payment of the guarantee out of their own funds. Thereafter, on December 8, 1944, he entered into an agreement with the banks (R. pp. 49, 51) in which the other guarantors were also included, the substance of which was that Charles A. Cummins and his wife were to pay to the banks the sum of $86,000.00, and in consideration therefor the banks agreed to release all of the guarantors from any further liability on their guarantees. It was further provided that the banks would not reduce their claims against

the bankrupt by this amount but that any money recovered by them over and above that to which they were entitled would be refunded to Charles A. Cummins and his wife. The Circuit Court of Appeals in describing this transaction made the comment:

> "This was a proper arrangement for if the banks had reduced their claims by $86,000.00, this sum could have been claimed from the bankrupt by Charles A. Cummins." (R. p. 125)

The banks between them filed claim for approximately $105,783.11 in which, by this arrangement, Mr. and Mrs. C. A. Cummins were interested to the extent of $86,000.00, and the banks were interested to the extent of $19,783.11.*

The Offer of Settlement

The offer of settlement, which is the subject matter of the present litigation, is contained in two letters attached to the Trustee's petition (R. pp. 6, 10), and in a third letter written after the filing of the opinion by the District Court (R. p. 71). The Trustee's reasons for recommending the settlement are stated in paragraph "3" of the petition (R. p. 5) and in a full statement made to the Referee (R. p. 20).

Two counsel—Messrs. Patz and Grandberg—had for some time prior to the final hearing before the Referee,

---

* The banks were therefore in the position of becoming completely whole upon the declaration of a 20% dividend and any balance would under the agreement go to Mr. and Mrs. C. A. Cummins. If the $22,511.86 were to be restored by the banks, their total claim filed in the estate would be increased to $128,334.97, in which the bank's interest (assuming that the agreement with Mr. and Mrs. C. A. Cummins covered such a case) would be $42,334.97. Under these circumstances it is obvious that the return of the $22,551.86 later proposed in the offer of settlement was primarily at the expense of Mr. C. A. Cummins and his wife and not of the banks.

evinced an interest in the possible liability of the guarantors. Knowing of their interest, counsel for the Trustee invited them to be present and take part in the special examination of the bankrupt's officers; and both attended and took part in that examination (R. p. 76). Later, prior to recommending settlement, these individuals were informed of the Trustee's decision that the evidence would not support an action against the banks or the guarantors on account of the October 16, 1944, bank seizures; and they were requested to offer or disclose to the Trustee any additional evidence which they might have. At the hearing on the petition for authority to make the settlement, a very full statement was made by counsel of the results of the investigation made by the Trustee and reasons for the recommendation (R. p. 20). Counsel for the creditors was again called on to produce any additional evidence available (R. pp. 38-39). Mr. Patz did not stay for the full hearing but left Mr. Grandberg to take his place (R. p. 21). Mr. Grandberg admitted that he had no additional facts to offer to the Trustee but suggested that Mr. Patz had additional facts which were withheld (R. p. 39). We now quote from pages 39-40 of the Record:

> "(Mr. Grandberg) All the facts are not developed in that testimony. I think you will find that the cross examination was very short and you were permitted to go on with your own examination in chief and we did not develop our case at all.
>
> (Mr. Page) You mean you withheld?
>
> (Mr. Grandberg) We withheld cross examination of the various endorsers.
>
> (Mr. Page) Why, Mr. Grandberg?
>
> (Mr. Grandberg) Well, that seemed to be the strategy worked out at that time."

The Referee, after review of the entire matter, came to the following conclusion:

> "In the opinion of the Referee, the contents of the Trustee's petition for ratification of the offer of settlement were fully supported by the testimony and said offer should be accepted and ratified." (R. p. 19)

In the presentation of the case before the District Court, the matter was fully briefed and all aspects of the case were discussed in detail. The District Court came to the following conclusion:

> "The situation with which the trustee in bankruptcy was faced is very clearly and accurately stated by his counsel in their brief, as follows, and we are satisfied that their judgment was sound in advising the trustee in bankruptcy to accept the proposal with the sole qualification with respect to the interest item just discussed: 'Prior to determining to accept the offer the Trustee decided that he could probably win a contest against the Baltimore National Bank for restoration of the $22,551.87; and that, in the absence of facts unknown to him, he would fail on claims against either the banks or the guarantors on account of the October 16, 1944, transactions. During the investigation, the Trustee requested Mr. Grandberg, who was, together with Mr. Patz, representing dissenting creditors, to submit to the Trustee any additional facts known to them, and upon failure of them so to do, the Trustee has no reason to believe that any facts exist which would change the conclusions reached by him on his independent investigation. Having made the conclusions stated, the Trustee recommended the compromise settlement which will, in effect, require repayment of 100% of what the Trustee believes he is entitled to recover' " (R. pp. 69-70).

The matter was thereupon carefully reviewed by the Circuit Court of Appeals, which affirmed the action of the District Court (R. pp. 124-132).

The Institution of Suits Pendente Lite

Subsequent to the decision of the Referee ordering the acceptance of the compromise agreement, the objecting creditors, having entered an appeal from the said order, were permitted, pending the decision of the Court, to enter a suit in behalf of the estate against the guarantors. In the same manner, the Trustee, pending a final decision with regard to the compromise agreement, instituted a suit against the Baltimore National Bank to recover the $22,-551.86 seized by it on December 6, 1944; and also filed exceptions to the claim of that bank as a general creditor, for the same reason. The purpose of all of these actions was to avoid the bar of limitations pending a final determination of the creditors' objections to the compromise agreement (R. pp. 73, 20). The effect of a ratification of the compromise agreement will be to cause the dismissal of these various actions.

ERROR IN PETITIONER'S STATEMENT OF QUESTIONS PRESENTED

There are numerous inaccuracies in the Petitioner's Statement of Facts which will be considered in more detail in the appendix. The petition as a whole is prepared, however, upon an apparent misconception of the matters which are open for consideration of this Court.

(a) The Petitioner assumes that it is at liberty to question the good faith of the Trustee in recommending the settlement and in substance suggests that the settlement was nothing but a sham. Up until the present petition, the comments designed to reflect upon the Trustee's good faith have been oblique and no direct charge has been made. In the present petition, however, the following comment appears as part of two extremely offensive paragraphs of the Petitioner's brief (at page 2):

> "It is an almost irresistible conclusion drawn from the above, that the Trustee in this case is seeking, without possible gain to the estate, to free the guarantors from the necessity otherwise of responding in the pending plenary actions filed against them, is indeed appearing for the guarantors."

While the Trustee will not indulge in a formal motion to have this matter stricken out, it is believed proper to suggest that it is not only slanderous and impertinent as to the Trustee but apparently also includes in its scope the Referee, and both lower courts, who, after full hearings, have ratified and confirmed the Trustee's recommendations.

(b) The Petitioner assumes that it is still at liberty to discuss the good faith of certain of the guarantors and suggests that they caused the deposits in the Baltimore National Bank to be built up prior to October 16, 1944, for the purpose of permitting a set-off (Petition, pp. 3-4; Brief, p. 15). In this respect the Circuit Court of Appeals said:

> "Nothing has been brought to our attention to cast any doubt upon the finding of the Referee, approved by the District Judge, that 'the testimony definitely shows that the funds constituting these balances were deposited in due course of business, that no attempt had been made to build up these balances and no restriction had been placed upon the withdrawal thereof. Neither is there anything in the evidence to show fraud or collusion between the banks and the bankrupt corporation, or between the banks and the guarantors of the notes' " (R. pp. 127-128).

(c) These errors are reflected in questions 1 and 3 of the Petitioner's statement of Questions Presented (Petition, p. 8). We take question 1 as an example:

> "Where it is conceded that only the sum of money admittedly recoverable under any circumstances from

> the Baltimore bank is offered to the Trustee, should the Trustee, without any further consideration whatsoever, extend a release from the estate to four solvent, individual guarantors against whom the estate has (at the very least) a colorable claim for $68,500?"

This question in substance assumes that the compromise agreement was nothing but a sham of the character discussed in paragraph "(a)" above. Trustee had been advised by counsel that he would probably be successful in an action against the bank to recover the $22,551.86, which had been seized by it on December 6, 1944. On the other hand, neither the Trustee nor counsel have ever at any time "conceded" or "admitted" that the fund was "recoverable under any circumstances"; and at all times counsel for the Trustee have made clear that they recognized the possibility of a substantial and aggressive defense in any suit by the Trustee against the bank. The fact that the Trustee has not attempted to magnify these defenses but has contented himself with a frank statement that in opinion of counsel they could be overcome, has been seized upon by Petitioner as in substance a concession that the Trustee was getting nothing of value in the compromise settlement, and that the money would have been forthcoming in any event from the bank. That is not the case; and it is believed that the bank would have tested its rights by litigation, if no compromise had been effected. This in substance was the tenor of the comments made by the Baltimore National Bank in the offer of settlement; and it was confirmed by advice of the Trustee's counsel. The Trustee was advised, and is still advised, that the bank (and Charles A. Cummins, who was, of course, the person primarily affected) made a substantial concession when they agreed to repay the amount of the claim to the estate as a voidable preference. The Referee and the lower courts carefully reviewed the whole matter and found that the

proposed agreement was for the best interests of the estate. Under these circumstances the Petitioner should not now suggest that the whole transaction was a sham; or frame a question to this Court based upon such an assumption.

In the same manner, the error mentioned in paragraph "(b)" is carried into the above question in which the Petitioner includes an assumption that—

> "the estate has (at the very least) a colorable claim for $68,500.00".

The colorable claim could arise only in one of two ways: Either (1) upon proof that the guarantors had "built up" the deposits or in some way acted out of due course or in bad faith in making the deposits at the banks; or (2) upon the Petitioner's establishing *as a matter of law* that the guarantors received a preference without regard to the good faith and ordinary course in which the deposits were made. As above pointed out in paragraph "(b)", the first of these questions, which is one of fact, has been eliminated. Hence the Petitioner can develop a claim only upon establishing the matter of law. That matter of law is presented and properly stated in Petitioner's Question (2). If Petitioner's position on Question (2) is correct, the estate has more than a colorable claim: if incorrect, it has no claim at all, which is what the lower court found. Hence Question (1) merely confuses the issue and suggests an attempt to include in the matters presented to this Court the question of fact which at present is no longer open.

For these reasons the first question proposed is defective. In like manner, the third question suggested by Petitioner is defective for the same reasons.

Respondent therefore submits that both Question (1) and Question (3) improperly state the issues involved, and are not basis for issue of the writ.

THE RESPONDENT'S STATEMENT OF QUESTIONS PRESENTED

The second question set forth by the Petitioner's statement of "Questions Presented" does not suffer from the defect apparent in the other two questions. It reads:

> "Under section 60 of the Bankruptcy Act, regardless of the statutory right of set-off (permitted by section 68 between those having mutual debts or credits) allowed to the Baltimore banks, by which they applied the Bankrupt's balances in reduction of the note indebtedness, did not the guarantors, by reason of the enlarged scope and meaning of 'transfer' enacted by the Chandler Amendment in 1938, obtain a benefit, which is a voidable preference?"

Respondent offers no objection to this statement of law as the only question presented.

RESPONDENT'S POSITION ON THE MERITS OF THE PETITION

The decision of the lower court on the question of law presented by this petition for certiorari is fully sustained by the prior decisions of the same circuit, in the Lineberger and Crabtree cases, which are fully discussed by the Circuit Court of Appeals in its opinion (R. pp. 129, 130). These cases, and the decision in the present case, are not inconsistent with decisions in other circuits but are to the contrary in accord with the principles stated in a mass of decisions of the Supreme Court and other circuits, all as is more fully pointed out by the Circuit Court of Appeals in its opinion and by the District Court in its opinion.

The Trustee, in recommending the acceptance of the offer of compromise and throughout the litigation, has assumed that under the established law the *bona fide* action of the officers of the bank in permitting deposits to be made at the banks in regular course of business was not

a "transfer" within the meaning of the Bankruptcy Act. In view of the history of the Chandler Act amendments and the comments by text-book writers, it has also assumed that the Chandler Act did not effect any change in so far as this question is concerned. If the Trustee is in error in this regard and deposits so made are in fact transfers, then the Trustee will readily admit that the settlement is under the circumstances inadvisable. It is only because the Trustee has been advised that there is no reasonable possibility that the courts will reconsider their decisions in these cases that the Trustee has recommended the settlement. This was frankly stated by the Trustee to the Referee and both lower courts. Their approval of the Trustee's recommendation indicated their agreement with this conclusion. On the other hand, there is no harm in the Petitioner's asking this Court to reconsider that question, and the Trustee therefore offers no objection whatsoever to the presentation of the point of law presented by Petitioner's Question (2), if this Court believes that there may be any merit in the Petitioner's contention.

CONCLUSION

The Respondent strenuously opposes the grant of the writ based on Petitioner's Questions (1) and (3) on the ground that these questions are improper, and impertinent. He has no objection to the grant of the writ based on Question (2).

Respectfully submitted,

FREDERICK J. SINGLEY,
CHARLES G. PAGE,
Attorneys for S. Raymond Machen, Trustee in Bankruptcy of Cummins Construction Corporation.

APPENDIX

INACCURACIES AND MISSTATEMENTS IN THE PETITION AND IN THE PETITIONER'S BRIEF

It should be noted that the Petitioner offered no testimony at the hearing before the Referee, printed no testimony to support his contentions before the Circuit Court of Appeals,* and that Petitioner gives almost no references to the Record to support its Statement of Facts. Furthermore, Petitioner is fully aware of Respondent's objections to Petitioner's Statement of Facts, because in the court below, upon a somewhat similar misstatement of the facts, Respondent was forced to devote a section of his brief to the subject.**

Yet Petitioner glibly opens its summary statement of facts by the announcement that—

> "The pivotal matters of facts here involved are so free of dispute as to be virtually stipulated" (Petition, p. 3).

The error goes deeper. Petitioner's main object in both the statement of facts (Petition p. 3), the statement of "Questions Presented" (Petition p. 8), and in the "Introductory" part of the brief (Brief, pp. 1-5), is apparently to so state (misstate) the facts as to demonstrate, (1) that the deposits at the two banks were "built up" for the express purpose of relieving the guarantors of liability; and (2) that the proposed compromise was nothing but a sham,

---

* All oral testimony in the Record was printed at the request of the Respondent.

** See comments on Petitioner's "Statement of Facts" in Respondent's brief before the Court of Appeals at page 11 *et seq.*, where most of the misstatements below were particularized with references to the Record.

concocted by the Trustee to relieve the guarantors of liability. The holding of the Referee and the two lower courts is flatly contrary on both points. As to (1), all of these officials held that the evidence established that there was no building up or bad faith in making the deposits (see particularly Circuit Court of Appeals' opinion, R. p. 127-128). As to (2), the approval by the Referee and both lower courts of the proposed offer, is a certification to this Court that the proposed compromise was not a sham; and that the Trustee was fully justified in his actions (see particularly Referee's opinion, R. p. 19; District Court's opinion, R. p. 69-70).

Hence, while the testimony discloses no conflict of fact, Petitioner's *statement* of facts is definitely in conflict with Respondent's statement. The pivotal facts as recited by Petitioner are not "virtually stipulated"; and are in conflict with the Record and the findings of fact of the Referee and the two lower courts.

We now turn to certain of the details in the statement which are inaccurate and find that almost every clause in the first paragraph is wholly or partially in error.

(1)

Petitioner in its first sentence on the facts states:

> "for months prior to the adjudication on January 4th, 1945, it (the bankrupt) had ceased to function as an active and going concern," (Petition, pp. 3-4).

The "pivotal" period in the present case is the period from September 4, 1944, which commenced the four months' preference period, up to October 16, 1944, when the banks seized the deposits. We take it that Petitioner's statement is intended to be interpreted to cover that period. There is no Record citation and there is nothing in the Record to support the statement. As a matter of fact, the contrary is

quite evident. The ledger accounts of the various banks were offered in evidence (R. p. 79 *et seq.*) and the larger deposits from September 4, 1944, were analyzed (R. p. 81). Deposits at the First National Bank showed substantial payments from the following sources for construction work during this period: September 1st, Baltimore Pure Rye $5,271.00; September 2nd, Greyhound Bus Company $25,000.00, Rustless Iron and Steel $50,000.00; September 16th, Maryland Glass $1,274.00, Greyhound $188.00; September 20th, Bethlehem Fairfield $7,211.40; September 21st, Degman $26,795.43, Chevrolet $8,000.00; September 25th, Paul Jones Distillery $1,100.00, Emerson Hotel $351.00; September 29th, Reliable Stores $6,000.00, Bethlehem Fairfield $460.00, Baltimore Pure Rye $729.00; October 2nd, Rustless Iron and Steel $6,500.00, Eastern Stainless Steel $2,500.00, Ivy City job (Washington) $4,367.00; October 7th, Bethlehem Fairfield $31,900.00; October 10th, Eastern Stainless Steel $2,907.47; October 13th, Mount Vernon Woodberry Mills $20,534.00, Eastern Stainless Steel, about $6,700.00, Maryland Glass $4,200.00, Rustless Iron and Steel $5,600.00 (R. pp. 81-87). And at the Baltimore National Bank: September 13, 1944, Miscellaneous items from Westinghouse, Emerson Drug, Reading Sales, Mount Vernon Woodberry Mills, Oriole Cafeteria, $5,340.00; October 6th, Emerson Drug Company and Rustless Iron and Steel, $25,726.04 (R. p. 91); September 25th, Edgewood Arsenal (Government) $10,000.00 (R. p. 93). And at the Maryland Trust Company: September 7, 1944, Chevrolet $11,246.00, Maryland Ice $300.00, Maryland Drydock $3,500.00, Greyhound Bus Terminal $10,000.00 (R. p. 99).

Petitioner was represented at the taking of this testimony (R. p. 76). It is obvious from the above that the bankrupt was actively engaged in construction work during the period up to the freezing of its accounts on October 16, 1944.

(2)

Petitioner states in the next clause:

> "it (the bankrupt) had long been pressed by its outstanding creditors for payment" (Petition, p. 4).

We assume that this is intended to apply to the same period (September 4th - October 16th, 1944). Here again the Petitioner is in error. There is, of course, evidence that the bankrupt was in need of money. But the bank accounts introduced in evidence show large disbursal of funds, as the same were collected, up until October 16, 1944; and on the very day when the bank accounts were frozen there were $23,000.00 in outstanding checks to clear (R. p. 85-87). While these checks were, of course, refused by the banks, it is obvious that the business was not at a standstill as suggested by the Petitioner.

(3)

Petitioner next states:

> "a large Government contract had been earlier terminated" (Petition, p. 4).

This is obviously inserted to indicate that the concern was hanging on by its eyeteeth as a result of the termination. The large Government contract referred to was the Cedar Point contract, which had been terminated for the convenience of the Government *early in 1943* (R. p. 22). There is no evidence whatsoever that this termination had anything whatsoever to do with the bankrupt's condition in the fall of 1944; or in fact that the contract itself was carried on at a loss.

(4)

Capitalizing on the above mentioned misstatements, "(1)" to "(3)", Petitioner finally, at the close of his brief, makes the following argument:

"In the cause at bar it is equally evident that the Guarantors received a preferential benefit; though of course since they were in active control of the bankrupt *and now admitted to have had prior knowledge of its insolvency (or better than reasonable cause to believe that the debtor was insolvent)* these Guarantors may also be said to have induced or brought about a situation, *by continuing* to make deposits in the Banks holding the bankrupt's indebtedness guaranteed by them, as a result of which they obtained these benefits * * *" (Petitioner's Brief, p. 15). (Italics ours.)

It is needless to say that the Respondent has made no such admission.*

(5)

Petitioner at page 4 of the petition states:

"With knowledge of the right of the two Banks to apply or set-off any balances in bank in reduction of the corporation's outstanding note obligations held by such Banks (which application would reduce the individual liability of the Messrs. Cummins as guarantors) the Officers (Guarantors also) continued in the weeks prior to October 16th, 1944, to make deposits of corporate funds in such Banks, though they also maintained a third depositary, to which Bank the Company was not indebted (R. 32)."

This again is inaccurate. The evidence shows that the Treasurer of the corporation was Mr. Brannan (R. p. 89); but that the responsibility for making the deposits was in

* In making the above comment, it should be borne in mind that the courts declare that mere knowledge of insolvency, in and of itself, is insufficient to transmute a deposit, otherwise in good faith and in ordinary course, into a preference. This state of the authorities does not, however, justify the Petitioner in easing the burden of its contention by stating, as though they were admitted, facts which are not apparent from the Record, and which it would no doubt have the greatest difficulty in proving.

the Assistant Treasurer, Mr. Hart (R. p. 78-79). Neither of these persons were guarantors. While there perhaps can be no doubt that Mr. Hart would have obeyed instructions if told by Albert Cummins to deposit particular money at any particular location, his testimony was that he acted on his own discretion without instructions from them (R. p. 78-79; 90-91). There is no evidence to the contrary.

(6)

Petitioner at various places speaks generally of the guarantors as officers, directors and stockholders; as though all occupied each position. Actually an important exception was Charles Cummins, who was not an officer (R. p. 88); was not active in business (R. p. 121-2). There is no evidence to show that he was a director.

(7)

Petitioner speaks of the assignment by the bankrupt to the Baltimore National Bank of proceeds of the Cedar Point contract as "inadvertently unrevoked" (Petition, p. 4). There is nothing in the Record to support the comment that the failure to revoke was inadvertent; and Petitioner was so advised by Respondent's brief before the Circuit Court of Appeals at page 13.

(8)

In an effort to substantiate its claim that the Baltimore National Bank did not "under any circumstances" have a claim to retain the $22,551.86 seized by it on December 6, 1944, Petitioner refers to the assignment to the bank as one—

> "by which sums payable under the joint contract would be paid to the Baltimore bank, as agent, *only* to secure

> repayment of the unpaid loans to be made by the Banks to the joint venturers for use *only* in the joint undertaking;" (Petition, p. 5). (Italics are Petitioner's.)

There is no citation to the Record to support this comment.

Petitioner did not include the assignment in the printed Record; and only included an excerpt from the loan agreement (R. p. 52). There is nothing which we know of in either document which makes any statement to the above effect. While it is doubtless true that the bank held the assignment for the benefit of the banking syndicate to secure loans made by the syndicate, those loans had been repaid and time for new loans had expired. There was nothing in the agreement which specifically provided that the bank could not thereafter, by agreement, hold the bankrupt's share for its own security. Later the bank made its claim to a right to retain the funds on that very ground, under the terms of its notes (see offer of settlement, R. pp. 6, 7-8; form of note, R. p. 46). While the Trustee announced to the Court that he was advised that the bank's claim could be overcome, the fact was not conceded by the bank and it was recognized by the Trustee that litigation would be necessary to establish the fact. Hence we take issue with the above statement by Petitioner as one of those facts "virtually conceded"; and particularly so when the statement is used as a basis to later allege in the statement of "Questions Presented" that—

> "*it is conceded* that only the sum of money *admittedly recoverable under any circumstances* from the Baltimore bank is offered to the Trustee" (Petition, p. 8). (Italics ours.)

as consideration for the settlement.

(9)

The Petitioner's statement of facts recites:

> "Numerous creditors opposed such alleged compromise, in behalf of whom these Petitioners are acting" (Petition, p. 6).

Of course the Petitioner's action, if successful, would benefit all creditors. As Petitioner says, creditors' claims exceeded $410,000.00 (Petitioner's Brief, p. 4). We take the Petitioner's statement, however, to infer that Petitioner is merely one of a large number of objecting creditors who are acting jointly in filing this petition. The Record indicates the contrary. Objections were originally made by twenty-two clients of Messrs. Patz and Grandberg (R. p. 14-15). The eleven creditors represented by Mr. Grandberg did not appeal from the Referee's order. Of those represented by Mr. Patz, only two appealed from the Referee (R. p. 15). Those two later appealed from the District Court to the Circuit Court of Appeals (R. p. 123). Mr. Grandberg's appearance was not entered in that appeal (R. p. 123) nor does he appear here either as attorney or of counsel. The present petition is filed by only one of the two creditors who appealed to the Circuit Court of Appeals. Unfortunately, we are unable to state either the amount of the present Petitioner's claim against the bankrupt estate, or the reason for the failure of the other creditors to join in the present petition; because neither fact is a part of the Record in this proceeding. Suffice to say, that the Record does not show that the Petitioner appears for anyone but itself and this Respondent is unwilling to accept the statement of Petitioner for more than what the Record shows.

(10)

Finally in the Petitioner's brief there are further statements of facts which are made at the top of page 2 of Petitioner's brief to the effect that the Trustee is

> "a close personal friend and sometime business associate of the guarantors".

This is a repetition of a statement made in the court below which was designed to reflect on the good faith of the Trustee. The nearest approach to any evidence in this regard in the transcript was the testimony that Mr. Machen went with Albert Cummins to the Baltimore National Bank on October 16th in an effort to obtain an extension of credit from the bank (R. p. 107-108). Mr. Albert Cummins, President of the bankrupt, then testified:

> "Q. In what capacity did Mr. Machen go with you? A. I guess it was more or less as a friend and a large creditor at the time.
>
> Q. He was an officer of the Baltimore Steel Company, which is the largest creditor? A. Which is the largest creditor we have."*

There is no testimony of any character that the Trustee was a "sometime business associate of the guarantors". With these comments as a background, the Petitioner goes on to say:

> "Ordinarily it would be expected that a Trustee in bankruptcy would not be so zealous as to come to the aid of challenged recipients of preferences.
>
> "It is an almost irresistible conclusion, drawn from the above, that the Trustee in this case in seeking, without possible gain to the estate, to free the Guarantors from the necessity otherwise of responding in

* Though the Record does not show it, this statement is not strictly accurate, as the indebtedness to one of the banks exceeded that to the Baltimore Steel Company.

> the pending plenary actions filed against them, is indeed appearing for the Guarantors" (Petitioner's Brief, p. 2).

Comment has already been made on these scandalous and unsubstantiated allegations. Suffice to here again point out that the actions of the Trustee were based on specific recommendations of his counsel who assumed full responsibility therefore (R. p. 44). His recommendations have been carefully scrutinized by the Referee, and the courts below; and by their approval and ratification, the acts complained of have become the acts of those officials.